

Jeffrey D. Saut, Chief Investment Strategist, (727) 567-2644, Jeffrey.Saut@RaymondJames.com

Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com

Andrew Adams, CFA, CMT, (727) 567-4807, Andrew.Adams@RaymondJames.com

Gleanings

A Monthly Chart Presentation and Discussion Pulling Together the Disciplines of Economics, Fundamentals, Technical Analysis, and Quantitative Analysis

“Manias”

In our travels over the past few months we continuously get asked about investing in bitcoin or the cannabis stocks. In our career we have seen many fads, manias, and bubbles. There was the great garbage market of the mid/late-1960s where any company whose name ended with “onix,” or “onics,” had its stock price soar and that soaring did not end well. Other manias include the Tulip Bulb mania (1634 – 1637), the South Sea bubble (1716 – 1720), the British Railway Bubble, the Florida real estate mania, etc. ([Manias](#)). More recently we experienced the Hula Hoop frenzy, the CB radio craze fostered by the oil embargo and the concurrent 55 mile per hour speed limit, the computer time-sharing mini-fad, Japan’s Nikkei mania, the Shanghai Stock Exchange bubble, etc. The seminal book on such subjects was written by Charles P. Kindleberger and titled *Manias, Panics, and Crashes: A History of Financial Crises*.

As our departed friend Ray DeVoe wrote in an era gone by:

These [fads] were all over quickly – but analysts sought “plays,” stocks to benefit from those trends as if they were to go on indefinitely. Nothing wrong with profiting from a temporary surge in a product’s popularity as long as it is recognized as a short-term phenomenon and a stock is bought to be traded. Looking for stocks to benefit from a trend brought to mind the sequence in Adam Smith’s book *Paper Money*. An aggressive money manager is told that half the young workers at General Motor’s Lordstown, Ohio assembly plant were hooked on heroin. The money manager’s eyes light up, and he immediately ask, “Wow, who makes the needles?!” I’ve been involved with this as well. During the 1968 rioting in the Watts section of Los Angeles I was repeatedly asked which stocks would benefit from the rioting taking place there – and also taking place in many American cities.

Text continues on page 3



Contents

Market Review with Jeffrey Saut..... 3

Stock Trends/Quantitative Analysis with Andrew Adams 7

Economic Review with Scott Brown 17

Important Disclosures 41

Jeffrey Saut

“Manias”

Continued from page 1

Devoe continued:

I should have kept my mouth shut. At a dinner for my firm’s clients I mentioned receiving dozens of requests for stocks to benefit from the riots. Facetiously, I put together a portfolio of companies including the maker of ambulances, the leading producer of tear gas, the largest anti-burglary protection company, a major domestic gun maker, a producer of home fire extinguishers, medical companies making bandages, anti-infection drugs, and replacements of human parts. Everyone thought it was very amusing – until, somehow the wire services found out about the “portfolio” and took it seriously. Just about every newspaper in the country picked it up and editorials featured “The callousness, insensitivity and “make a buck at all costs” attitude of Wall Street. It was a stupid thing to do, but I was far from alone in picking stocks to benefit from a fad based on some objectionable trend of disaster.

. . . But then, what is the difference between a fad, a mania, and a secular trend? One answer would have to include the time horizon expectation for each. A fad, such as the Hula Hoop, were recognized as such and it briefly crossed the investment world then disappeared never to be seen again. The trouble is that sometimes people “believe,” and come to think, that it can go on indefinitely. In that case you would lose just \$2.98 merely by buying one Hula Hoop to gyrate with, but you would lose \$3,000 by buying 100 shares of “Hulatronics of America” [there’s that “onics” again] common stock, or whatever company made the plastic rings.

Some fads go on for extended periods such as the bowling boom that propelled America Machine & Foundry and Brunswick into the stratosphere. For a while the growth in construction of bowling alleys was spectacular, actually it was better than that, it was exponential. And, when any growth is exponential, at some point you approach the limits of the physical world. . . . The same thing about exponential growth applies to technology stocks as well. At some point after a period of exponential growth you approach the limits of the physical world, or the limits of physics. In the case of AMF and Brunswick cited above, the stocks were so high that analysts’ recommendations were based on earnings projections three or more years out assuming still high rates of growth through those interim years. But here, growth was hitting physical or “real world” limitations. I made a rough calculation for those “out years” on the two companies. To get there, every man, woman and child in the country would have to bowl approximately five games every week, and that was just not going to happen. My sell recommendation came just before the peak of the fad. Unfortunately, as frequently happens in manias, few people would get out of the stocks with the outlook so rosy. They held on until the turn was obvious and by then it was too late.

The moral of this diatribe by Ray, and by us, is that fads, manias, and bubble always, and everywhere, end badly. We do not expect it to be different this time.

As for the overall stock market, we have been bullish on stocks since October 2008 when most stocks bottomed and we are on record back then suggesting the bottoming process had begun. Then on March 2, 2009, on Bloomberg TV, we stated that, “The bottoming process that began in October last year is complete this week and we are “all in.” Have we rebalanced portfolios, raise cash from time to time, layered in some downside hedges; yes we have, but it has always been within the construct of a secular bull market. Ladies and gentlemen, secular bull markets last 16, 17, 18+ years! So depending on where you want to count your “count” (October 2008, March 2009, or April 2013) this bull should have years left to run.

Jeffrey Saut

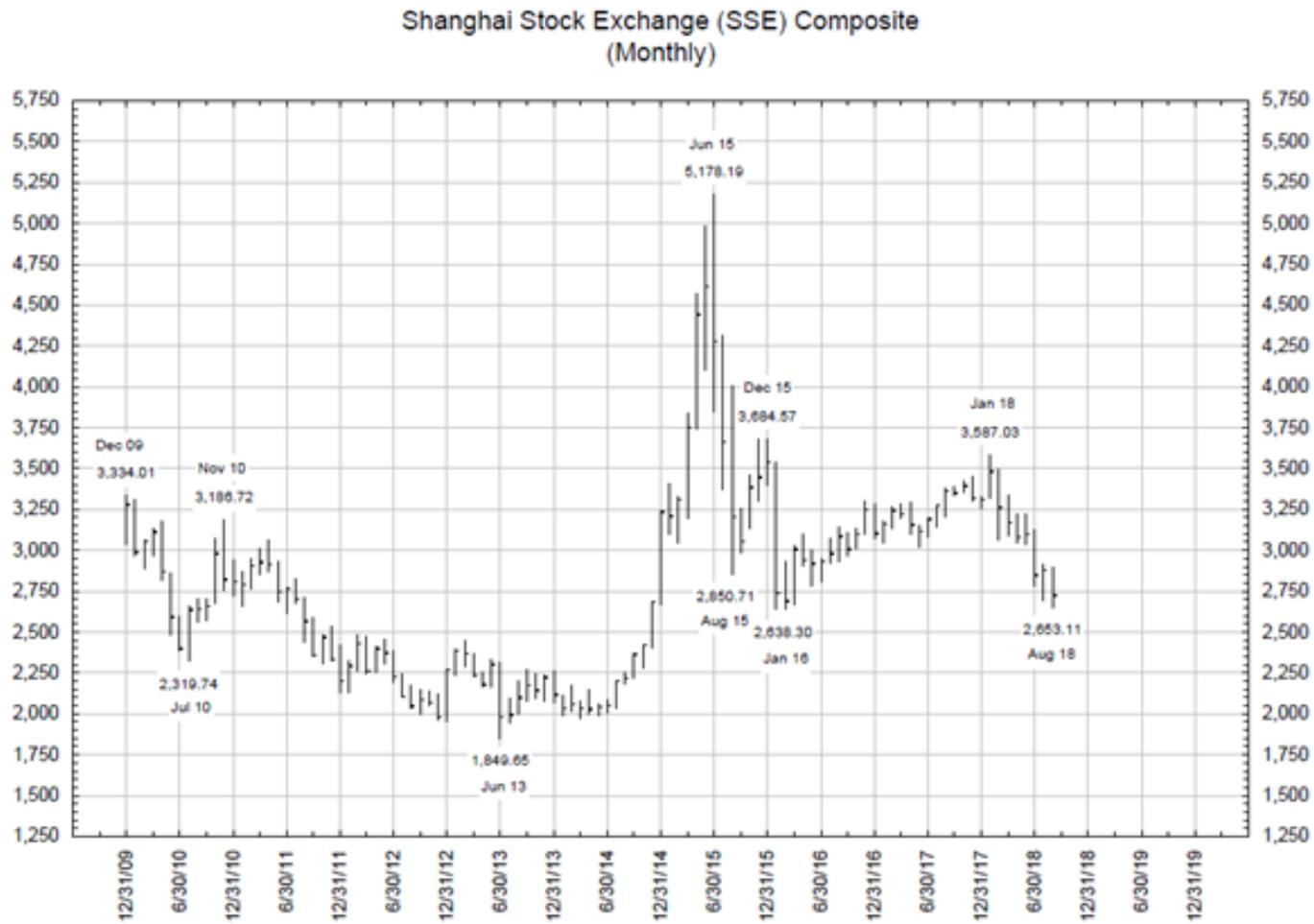
All Manias End Badly



Source: The Chart Store.

Jeffrey Saut

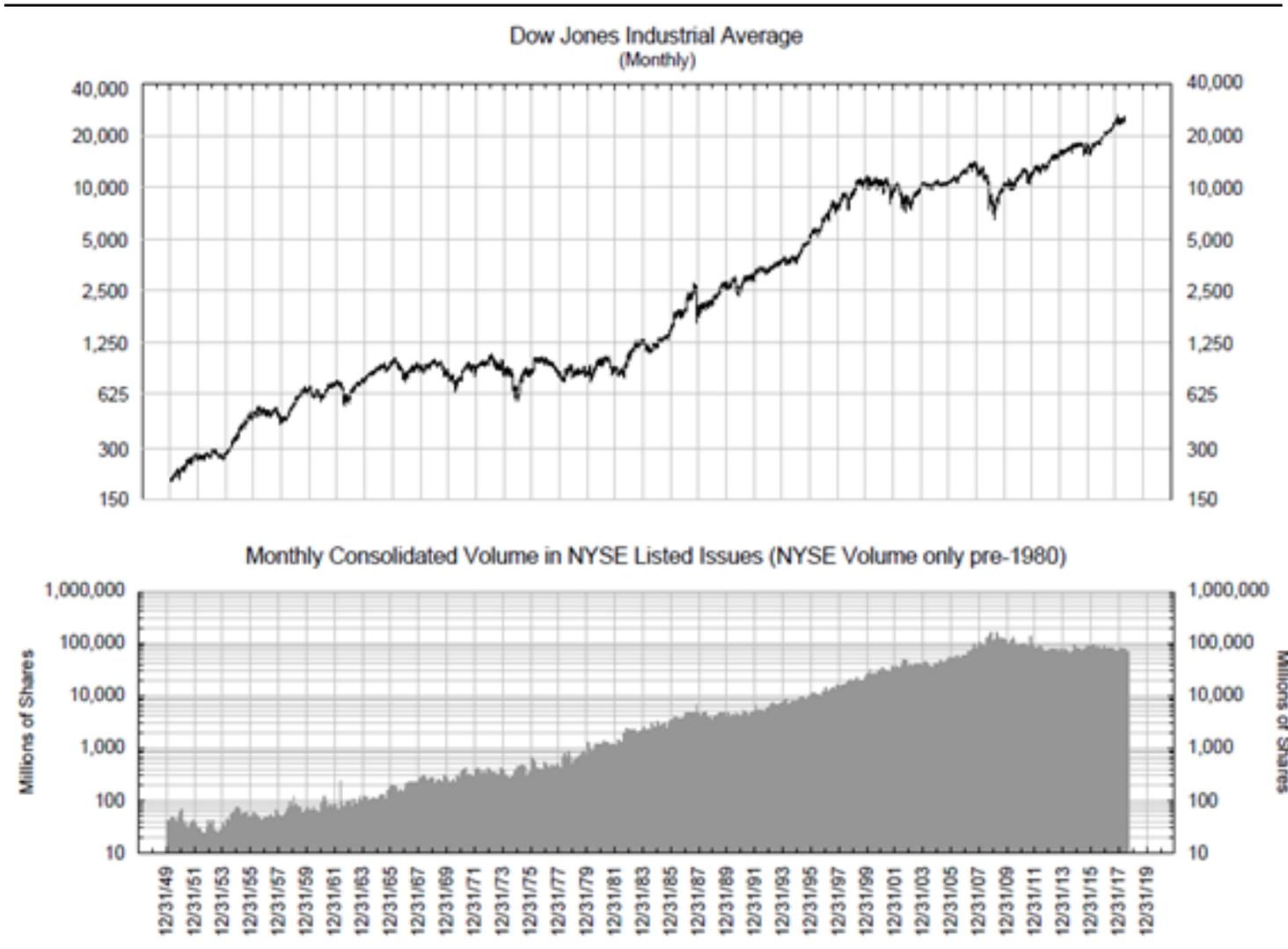
All Manias End Badly



Source: The Chart Store.

Jeffrey Saut

Never Underestimate the Power of a Secular Bull Market

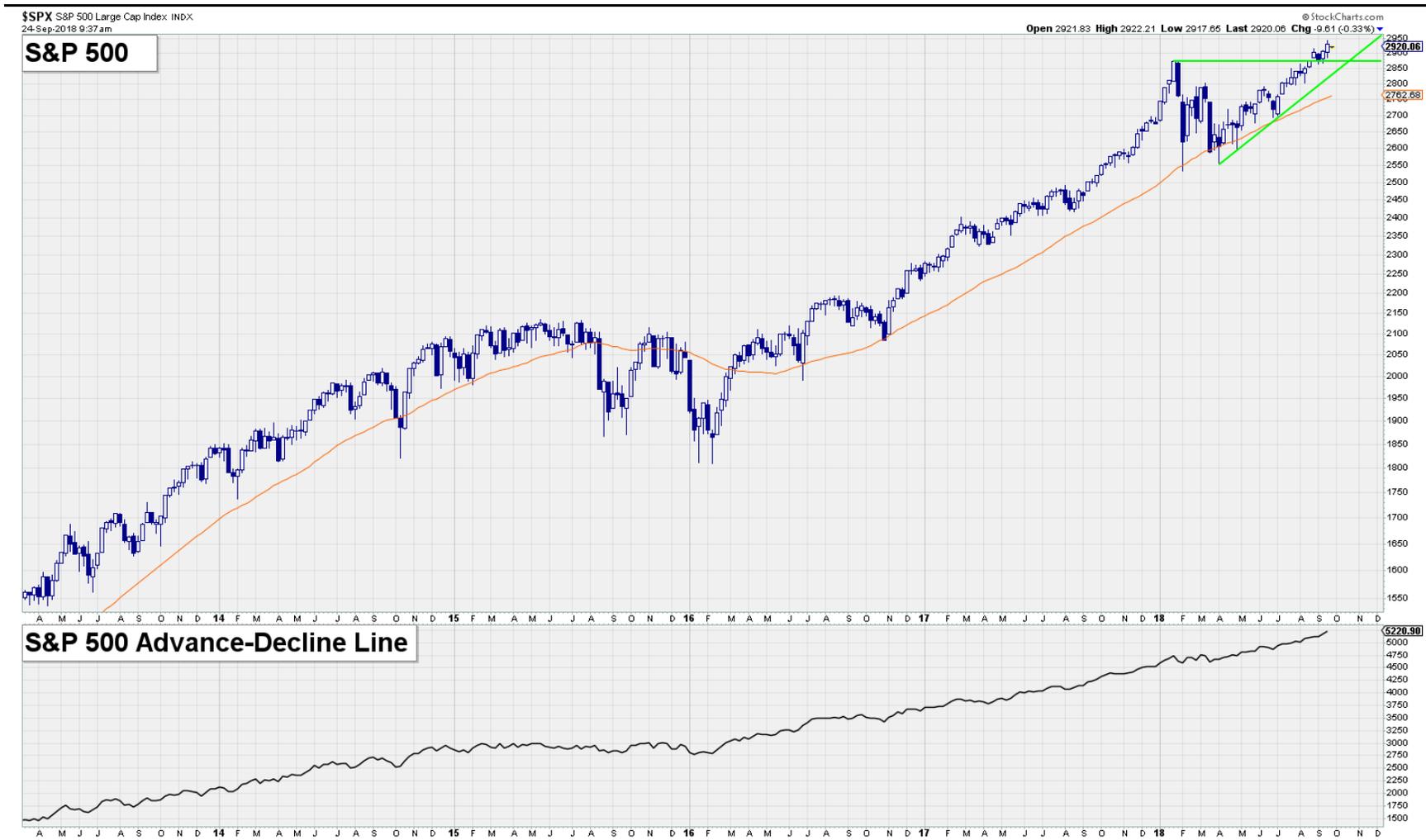


Source: The Chart Store.

Andrew Adams

This is What a Bull Market Looks Like

The S&P 500, despite worries about the trade war, continues to hit new all-time highs. At the same time, the S&P 500's Advance-Decline Line also has been hitting all-time highs, a sign that breadth remains supportive of the secular bull market.

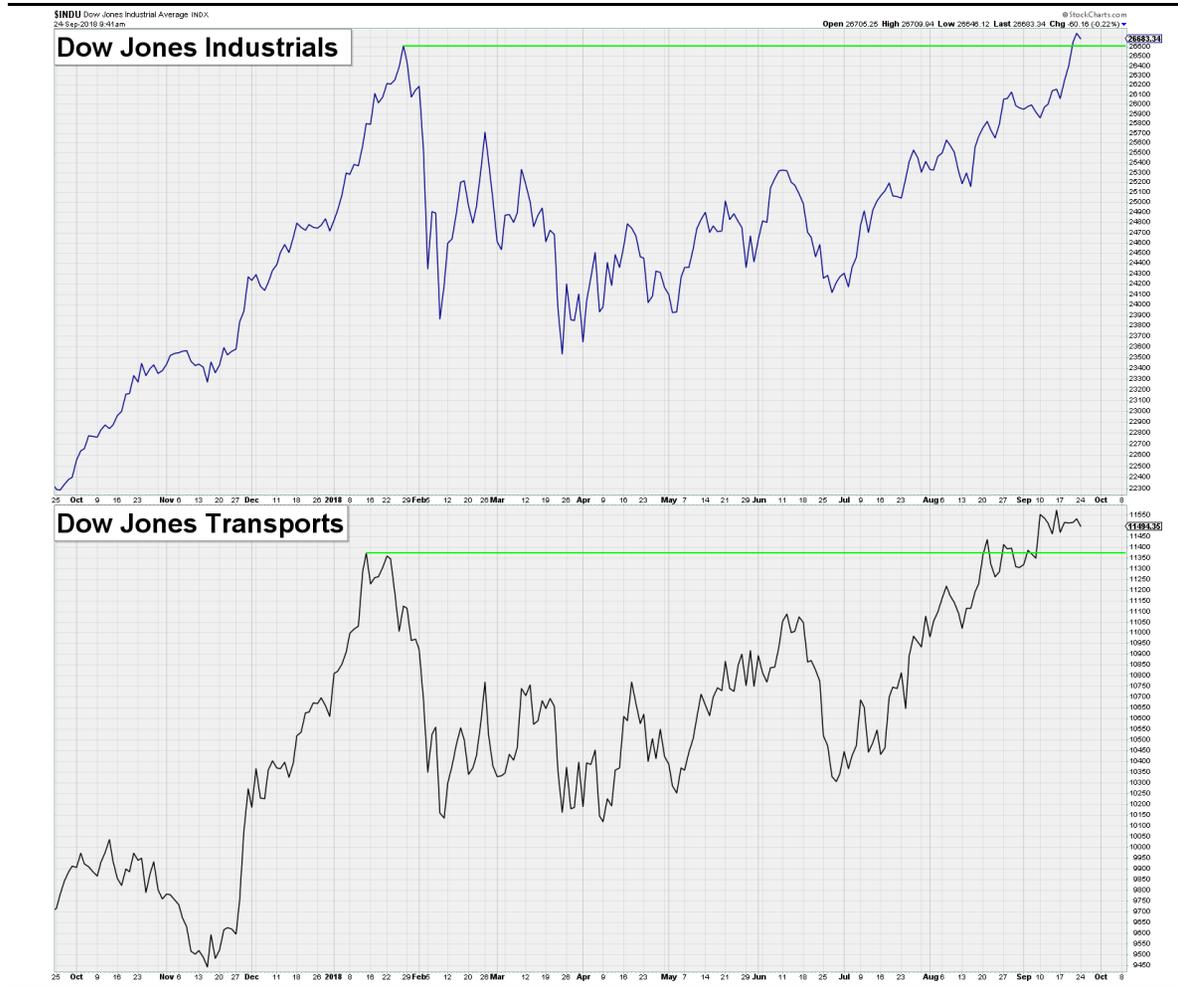


Source: Stockcharts.com.

Andrew Adams

Dow Theory Confirmation

The Dow Jones Industrial Average finally joined most other U.S. stock indices in breaking up above the January prior peak and closing at a new all-time high. The Dow Jones Transports did this back in August, and with the action of the Dow Jones Industrials we now have confirmation that the market remains in a primary uptrend according to Dow Theory.

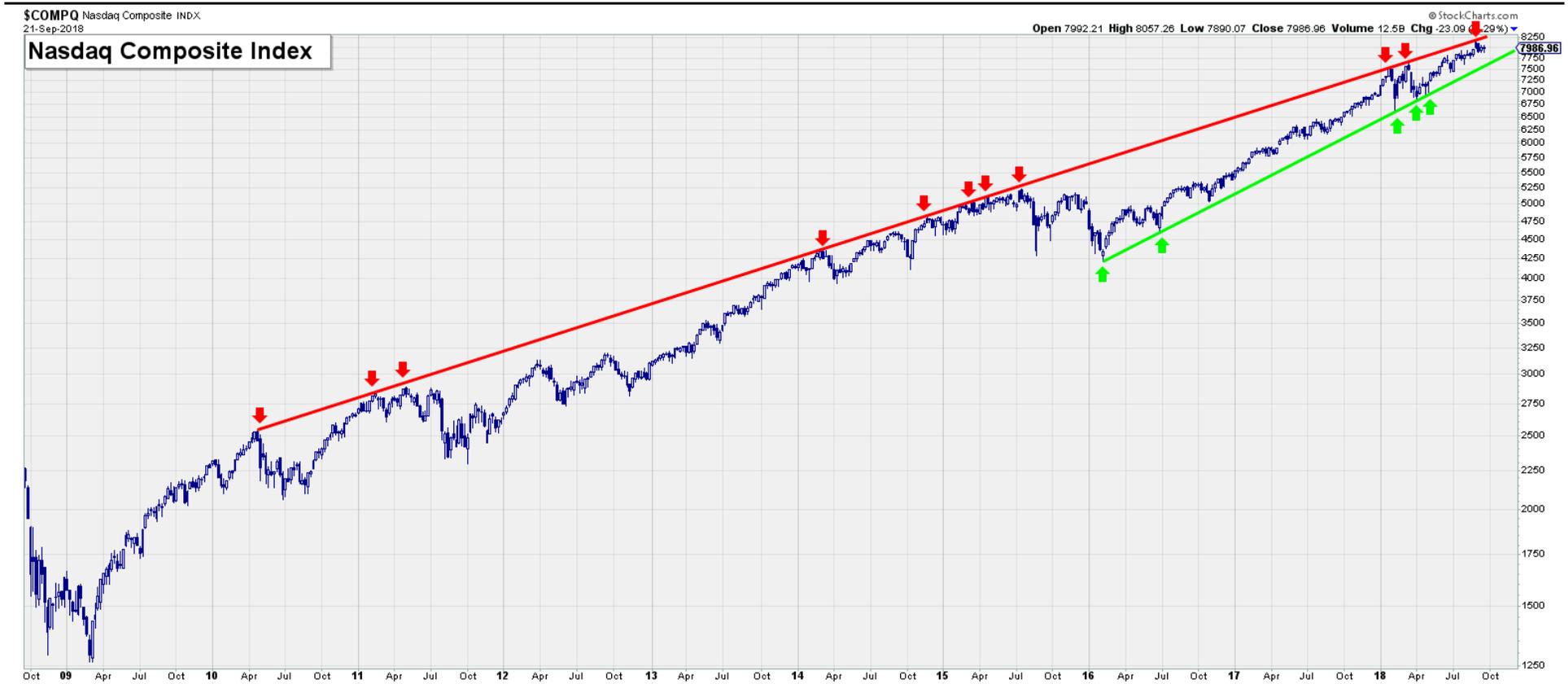


Source: Stockcharts.com.

Andrew Adams

Limited Upside for NASDAQ?

While overall conditions remain supportive of the secular bull market, it is worth noting that the tech-heavy NASDAQ Composite Index, which has routinely led during this bull market, may have limited upside in the near term. The red resistance line in the chart below has capped the NASDAQ going back to 2010, and unless the index can break out above it, it may represent the upside boundary for the NASDAQ. This does not mean, of course, that the index has to fall, but it may make it difficult to see another runaway upside move for stocks like we experienced in 2013 or 2016-2017.

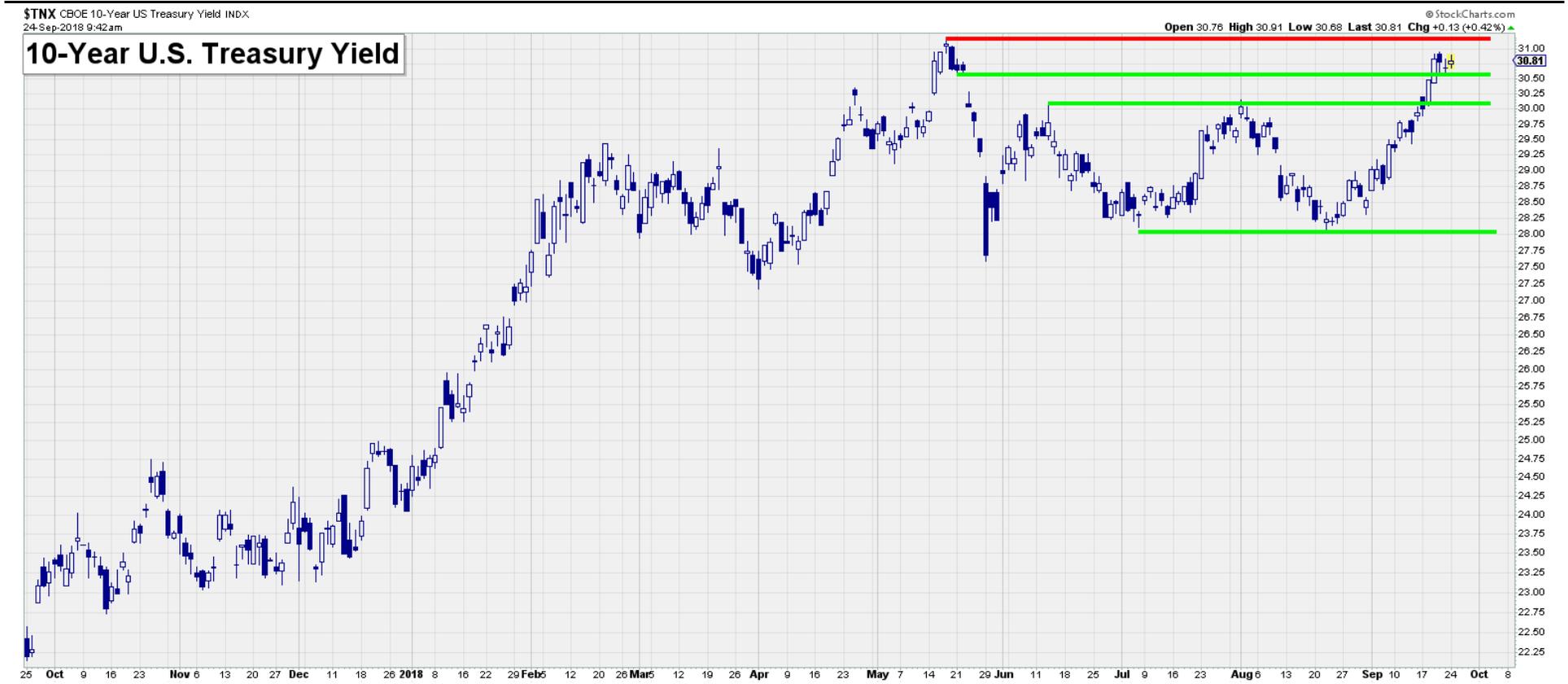


Source: Stockcharts.com.

Andrew Adams

10-Year U.S. Treasury Yield Update

The benchmark 10-Year U.S. Treasury yield has mostly been range-bound over the last few months. Recently, though, it has crept back up to just below its mid-May high around 3.10%, so it is worth keeping an eye on to see how it reacts in the coming weeks. A breakout to new reaction highs would imply that rates could be ready to start another leg upward.



Source: Stockcharts.com.

Andrew Adams

Crude Oil Also Range-Bound

WTI crude really hasn't done much worth mentioning over the last few months. It has mostly been contained within a \$10 range from \$65-75 and until that range breaks we have to assume it will remain trading sideways.



Source: Stockcharts.com.

Andrew Adams

U.S. Dollar Index Looking a Bit “Tippy”

Despite U.S. interest rates moving up in recent weeks, the U.S. Dollar Index has largely been under pressure. It even broke down through a couple of support lines in September (red lines), and with those violations the index has started to look like it could be forming a topping pattern. This would imply that we may have seen at least an intermediate-term reaction high set back in August.



Andrew Adams

Gold and Silver Bouncing Off Support

The weaker U.S. dollar has helped take some pressure off of commodities like gold and silver, which have performed terribly so far in 2018. The Gold and Silver Index, however, fell down to a zone that has a history of support (green shaded area) and that is helping to provide at least a temporary boost to the metals. It may be too early to call a definite end to their downtrends, but aggressive investors who have been watching for an opportunity in gold/silver may want to take a shot at them now.



Source: Stockcharts.com.

Andrew Adams

China Also Doing Better

China's stock market has been a clear loser during the months long trade war with the United States, as the Shanghai Composite Index was down 25% from its early year high at its recent low. However, the decline had taken the index down to an area of probable support, and that has so far helped stop the downtrend, at least temporarily. Like with many beaten down areas, it may be too early to call a definite end to the pressure, but there are signs that investors are becoming more interested in Chinese stocks once again.

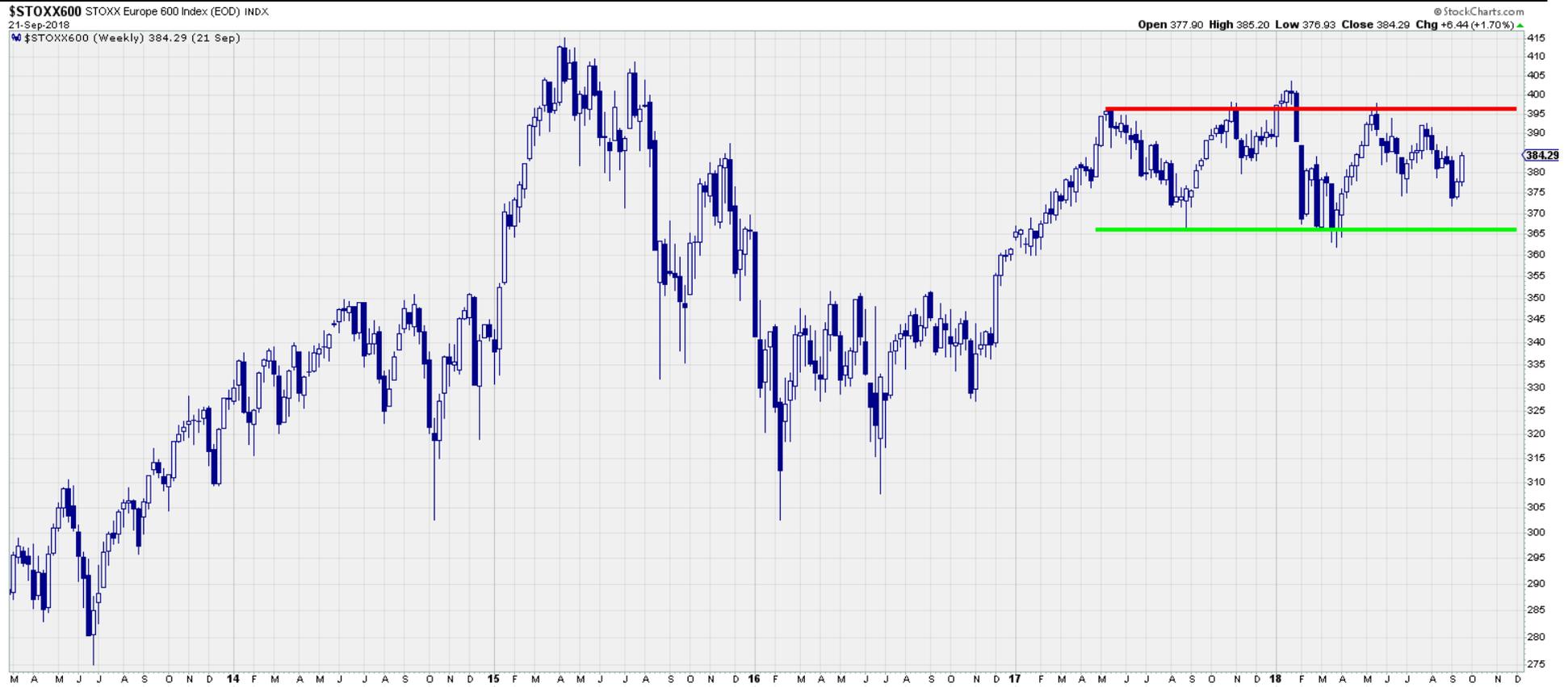


Source: Stockcharts.com.

Andrew Adams

Europe Waiting it Out

The Stoxx Europe 600 Index has not made much progress over the last year. It has largely remained range-bound and currently sits almost exactly in the middle of that trading range. Therefore, the charts aren't really providing much of a signal for where Europe may trade next, but we continue to watch for a break from that consolidation zone.

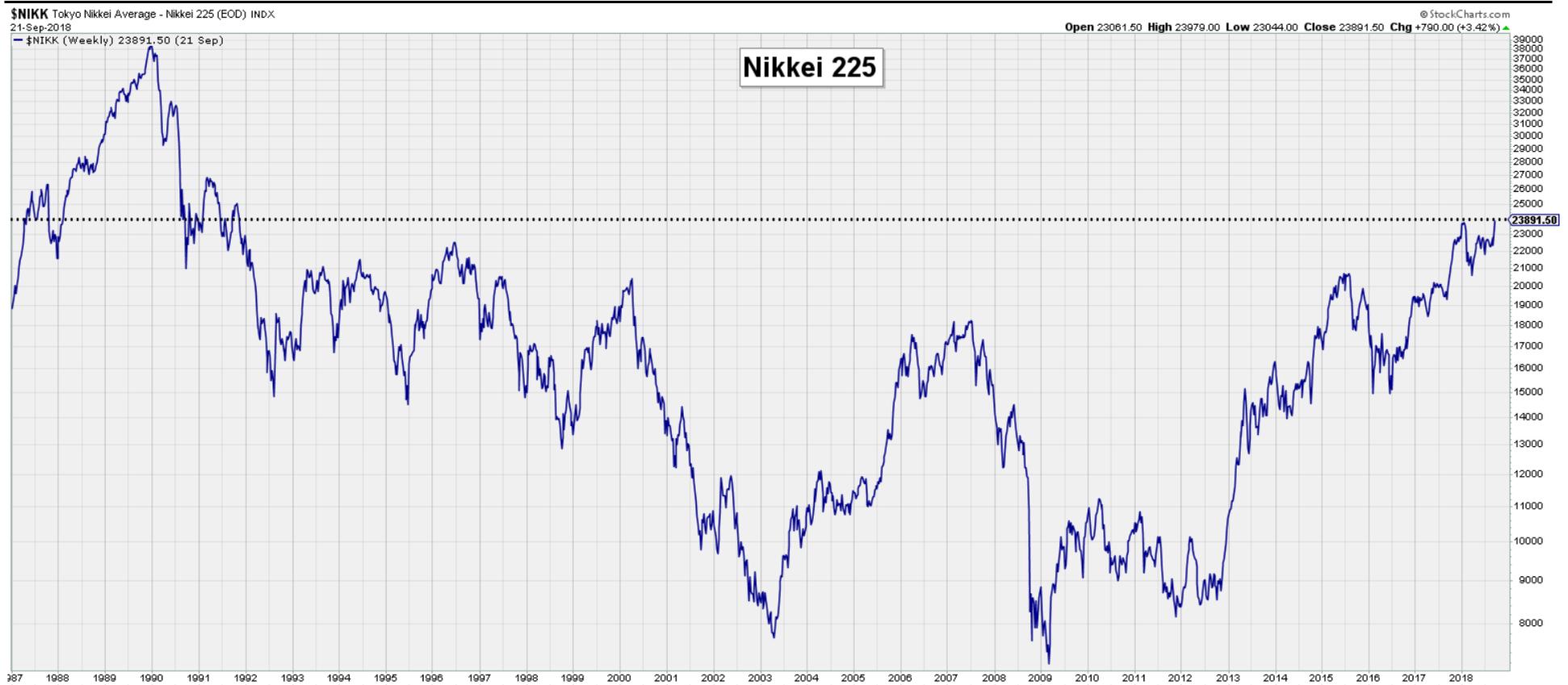


Source: Stockcharts.com.

Andrew Adams

Japan Looking Interesting

Japan's Nikkei 225 Index, however, does appear to be providing a bullish signal, as it recently closed at its highest level since 1991 after trading sideways for the last few months. This is a breakout worth watching and represents one of the clearest opportunities outside the U.S. stock market.



Source: Stockcharts.com.

Scott Brown

The Economy in Brief

The current economic expansion, which began in June 2009 and is the second longest on record, is widely expected to continue into 2019, but the pace of growth is likely to moderate, reflecting job market constraints, tighter (or less accommodative) monetary policy, and a smaller impact from fiscal stimulus (relative to the first half of 2018). Wage and price inflation is likely to be a bit higher. However, for a variety of reasons, inflation pressures are expected to be limited compared to historical norms.

The impact of import tariffs and foreign retaliation (against U.S. exports), while significant in some sectors, should have only a minor impact on overall GDP growth and inflation into early 2019. However, a further deterioration in trade relations remains a downside risk and will likely have important long-term consequences.

The Federal Open Market Committee is widely expected to raise short-term interest rates on September 26 and should no longer describe monetary policy as “accommodative.” Another hike is expected in mid-December. Fed officials are debating the risks of moving too slowly or too rapidly in the months and quarters ahead.

Scott Brown**Trade Policy** ☹️

This summer, President Trump imposed 25% tariffs on \$50 billion in Chinese goods (\$34 billion on July 6 and \$16 billion on August 23, mostly industrial inputs). China, which had warned of retaliation, responded with 25% tariffs on \$50 billion in U.S. exports (agriculture and cars). In response, President Trump imposed 10% tariffs on an additional \$200 billion in Chinese goods (intermediate goods, capital goods, and consumer goods) effective September 24, which will rise to 25% on January 1, 2019. The initial 10% was meant to limit the impact during the holiday shopping season. China indicated that it will respond with increased tariffs on U.S. exporters (including suppliers of inputs and capital equipment). In turn, President Trump has threatened to impose tariffs on an additional \$267 billion (effectively, all imports from China).

This latest action follows earlier tariff increases on imported steel, aluminum, solar panels, and washing machines. At this point, the White House has imposed trade restrictions on about 12% of U.S. imports, while our trading partners have responded with increased tariffs on about 8% of U.S. exports. Things are likely to get worse, before they get better.

Scott Brown**Trade Policy** ☹️

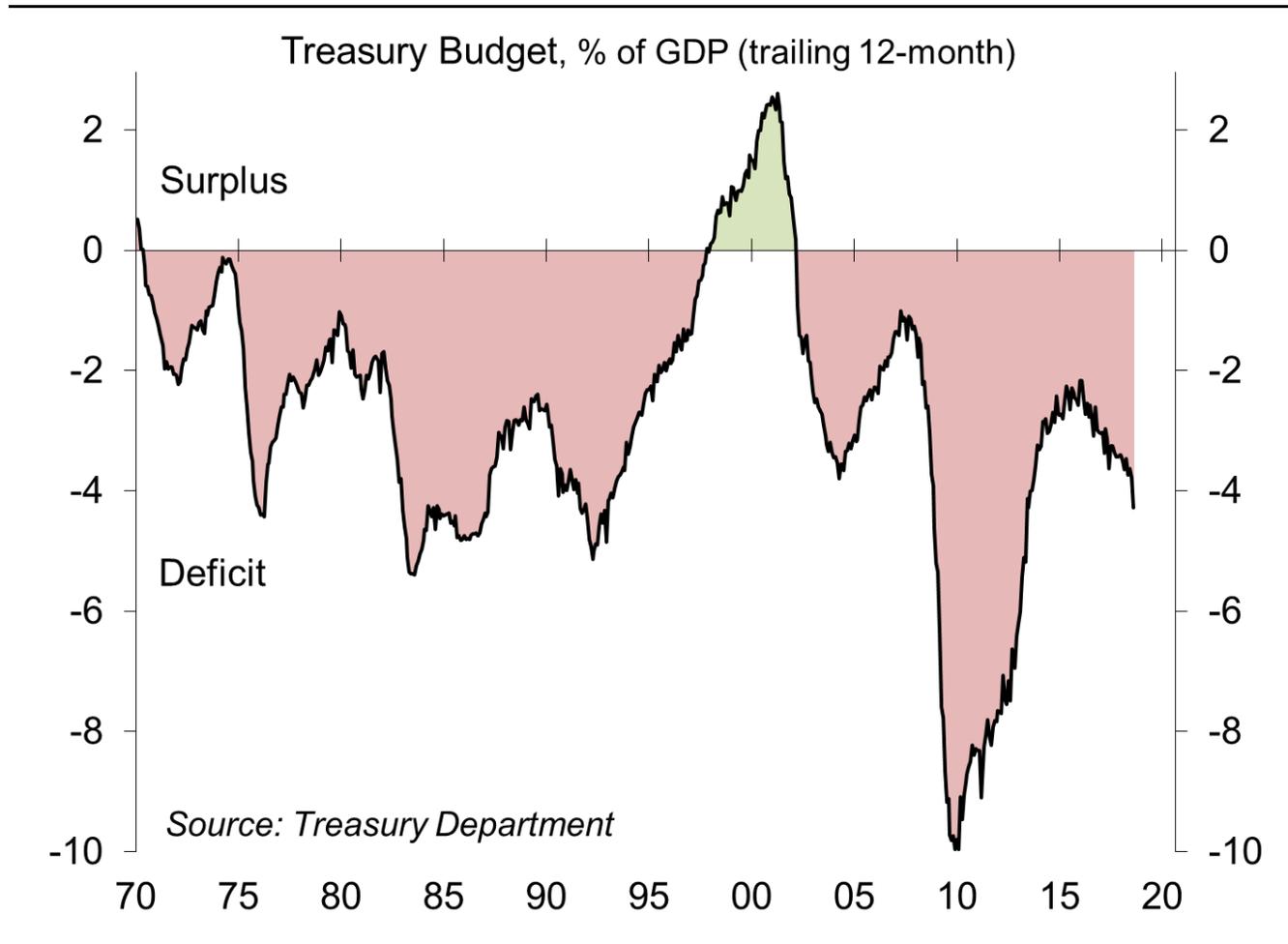
The focus on the U.S. trade deficit with China is misguided. Granted, China has been a bad player in global trade. However, the way to deal with that is through coordinated action with our allies (which is partly what the Trans Pacific Partnership was about). Our trade deficit with China is due to two key factors – and neither is “bad trade deals.” The first is that the U.S. consumes more than it produces (or equivalently, we don’t save enough). The second is that China is largely an assembler, pulling in inputs from outside the country and exporting finished goods. In this way, the U.S. deficit with China is really a deficit with the rest of the world.

Tariffs are a tax paid not by the foreign country, but by U.S. consumers and businesses. We should see somewhat higher inflation in the near term, but not a sharp surge over time. A lot will depend on whether we see a sustained increase in inflation expectations (probably not).

In recent decades, China’s economy has been centered on exports and infrastructure. It is transitioning to a more balanced economy, developing more internal demand. The current trade conflict threatens to leave the U.S. (and its companies) out of that growing market for a very long time.

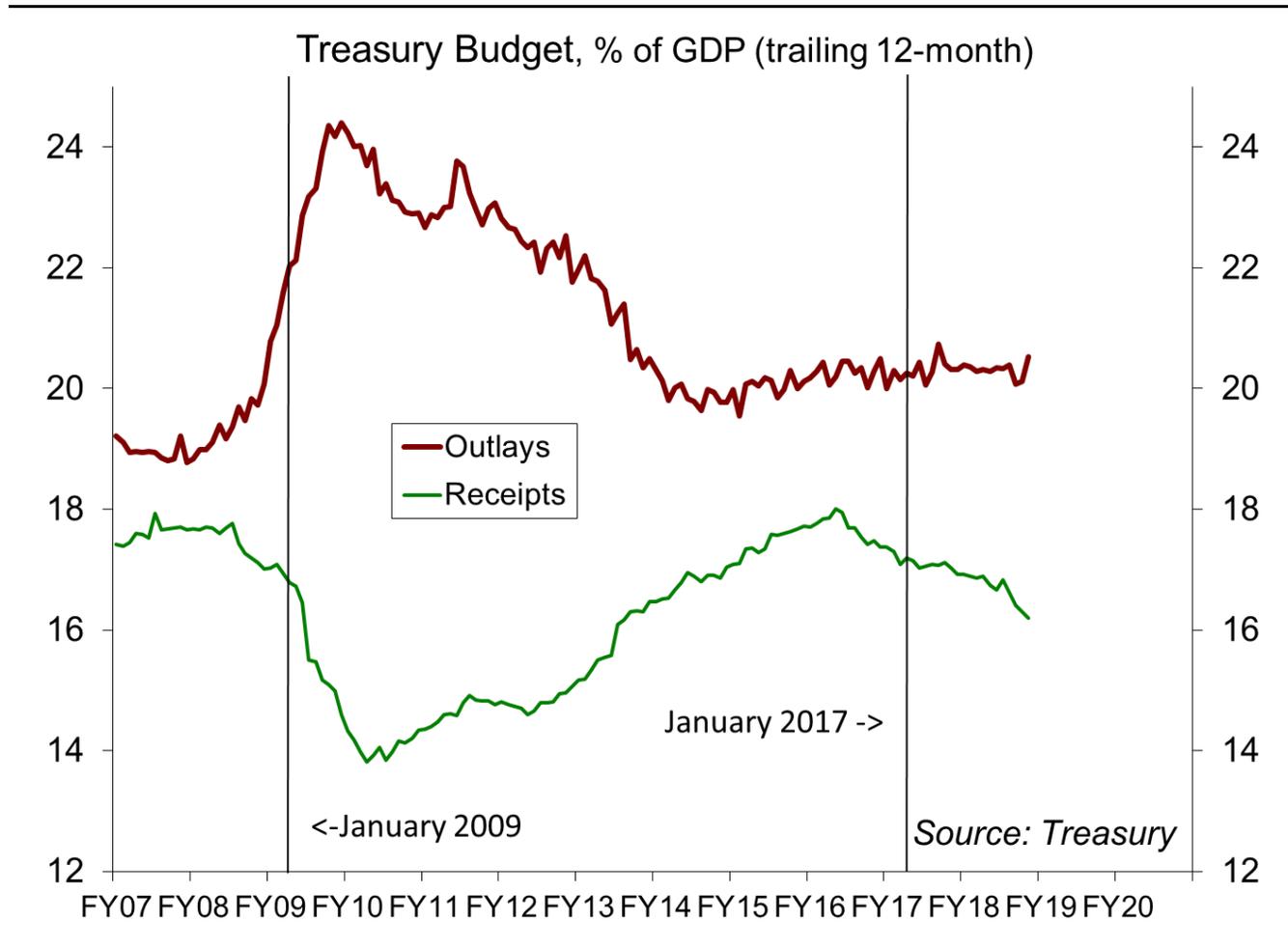
Scott Brown

Fiscal Stimulus = A Larger Federal Budget Deficit



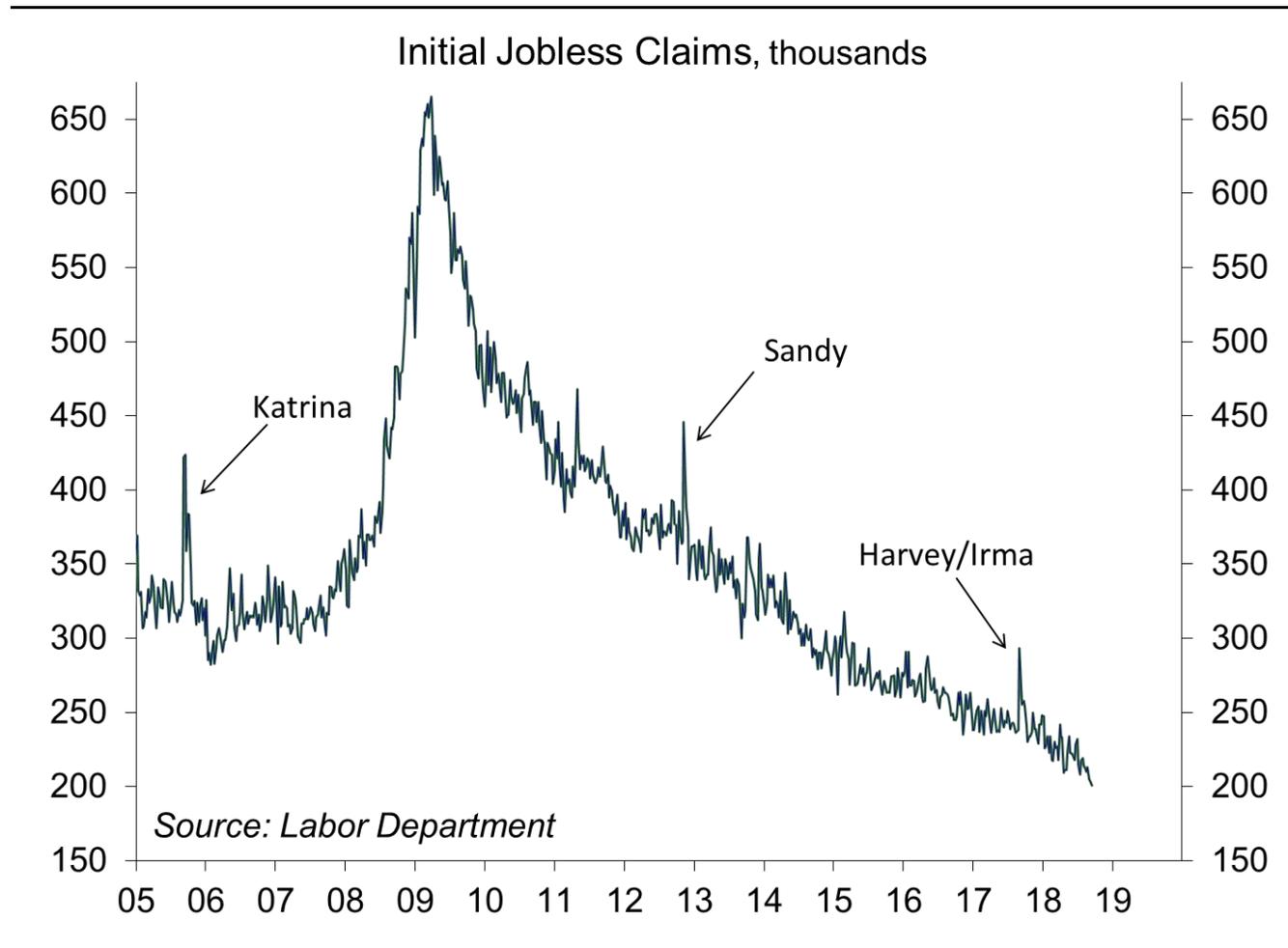
Scott Brown

Revenues Are Falling as a Percent of GDP



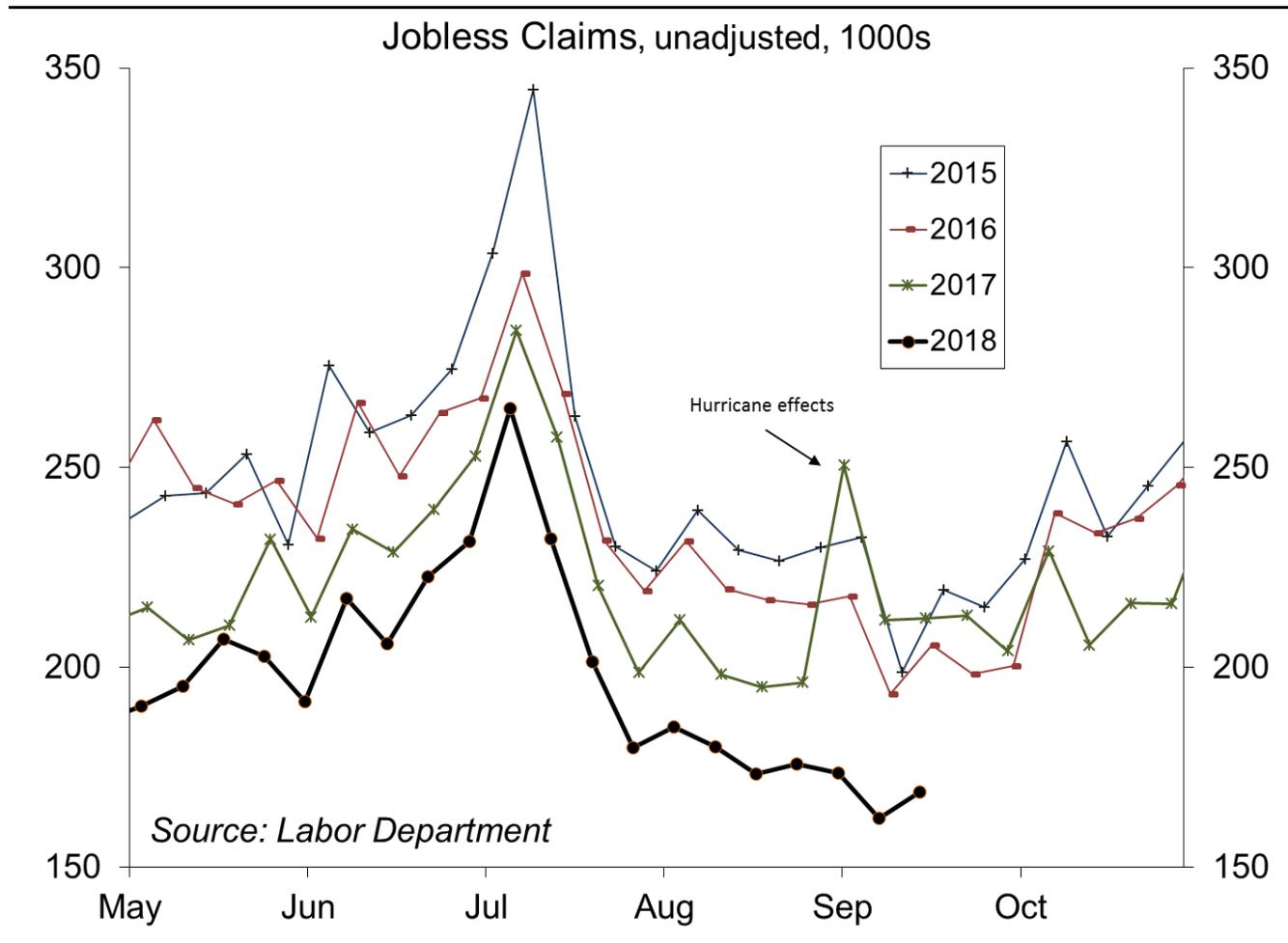
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Jobless Claims Are the Lowest Since the Late 1960s



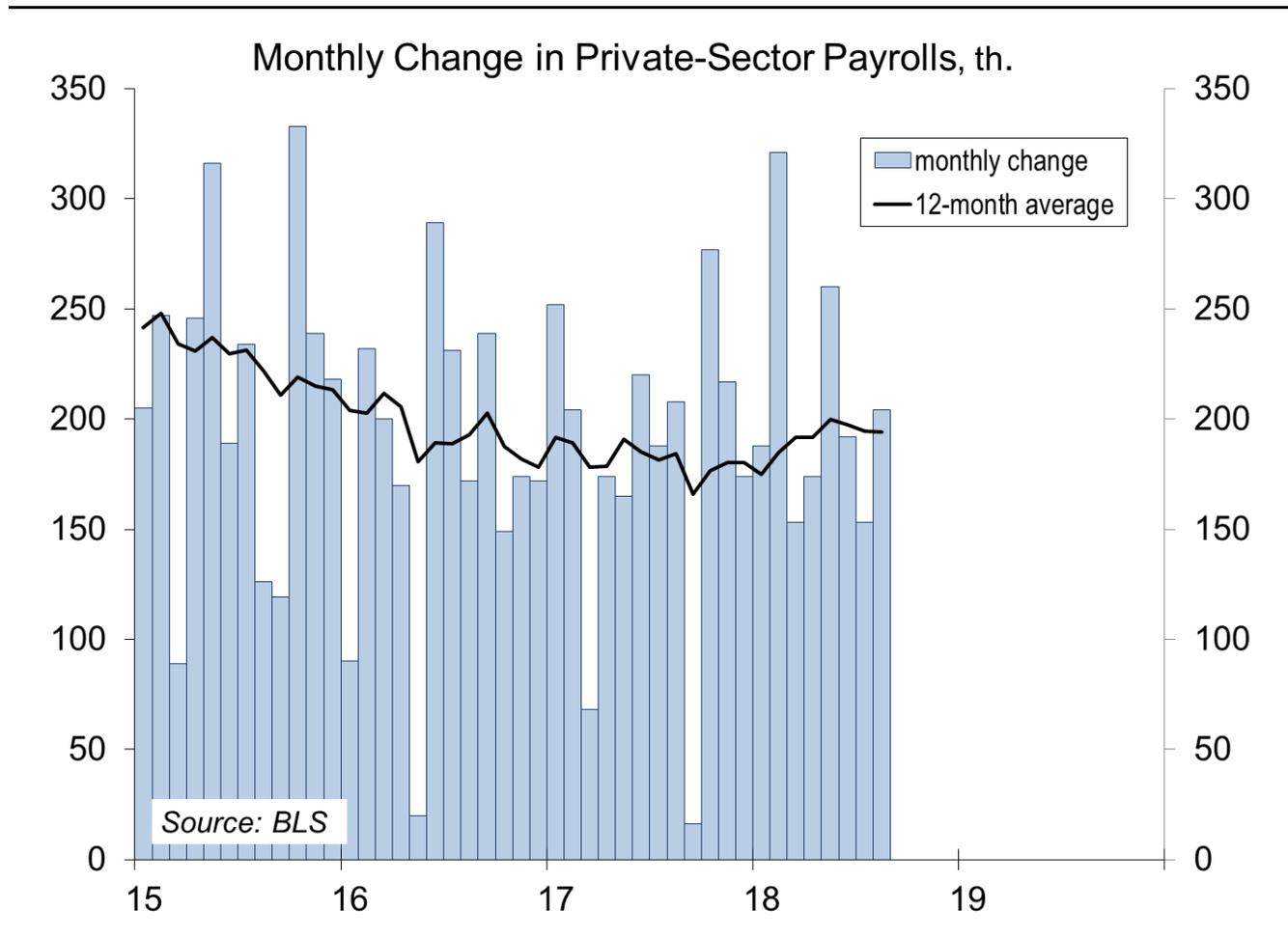
Scott Brown

Unadjusted Claims Are at Their Seasonal Lows



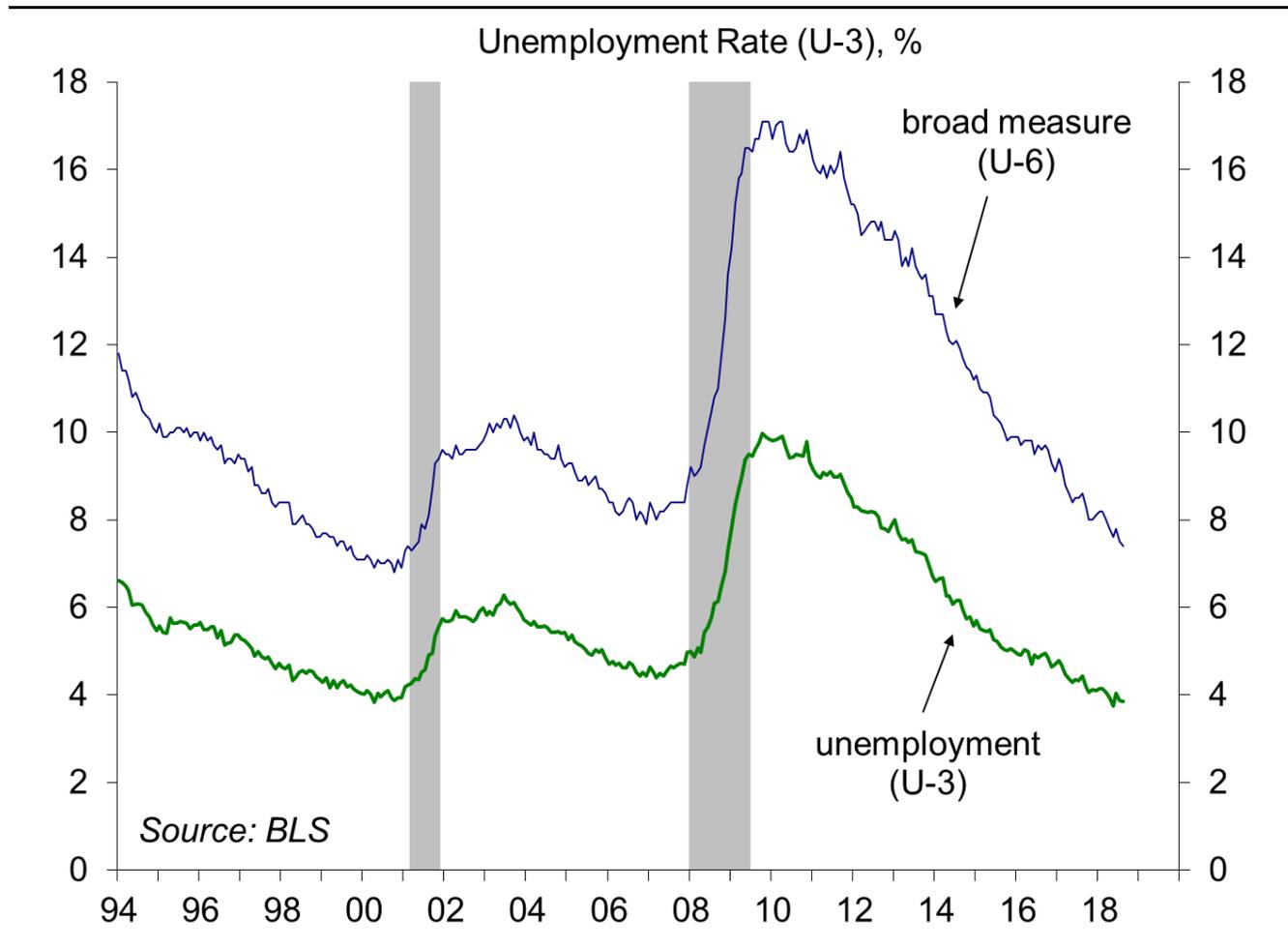
Scott Brown

The Recent Trend in Job Growth Is Not That Much Different Than That of the Last Few Years



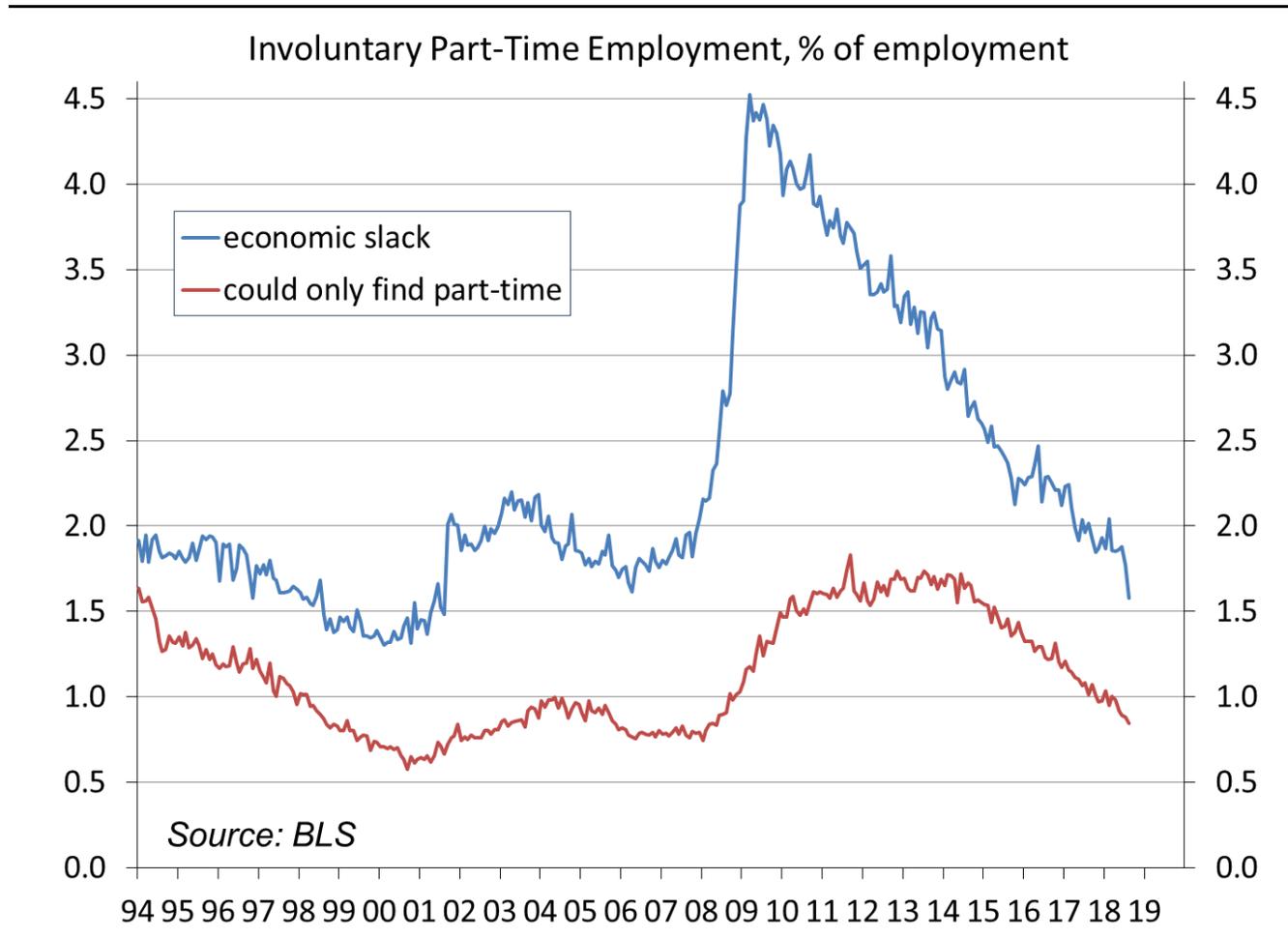
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The Unemployment Rate Is Low



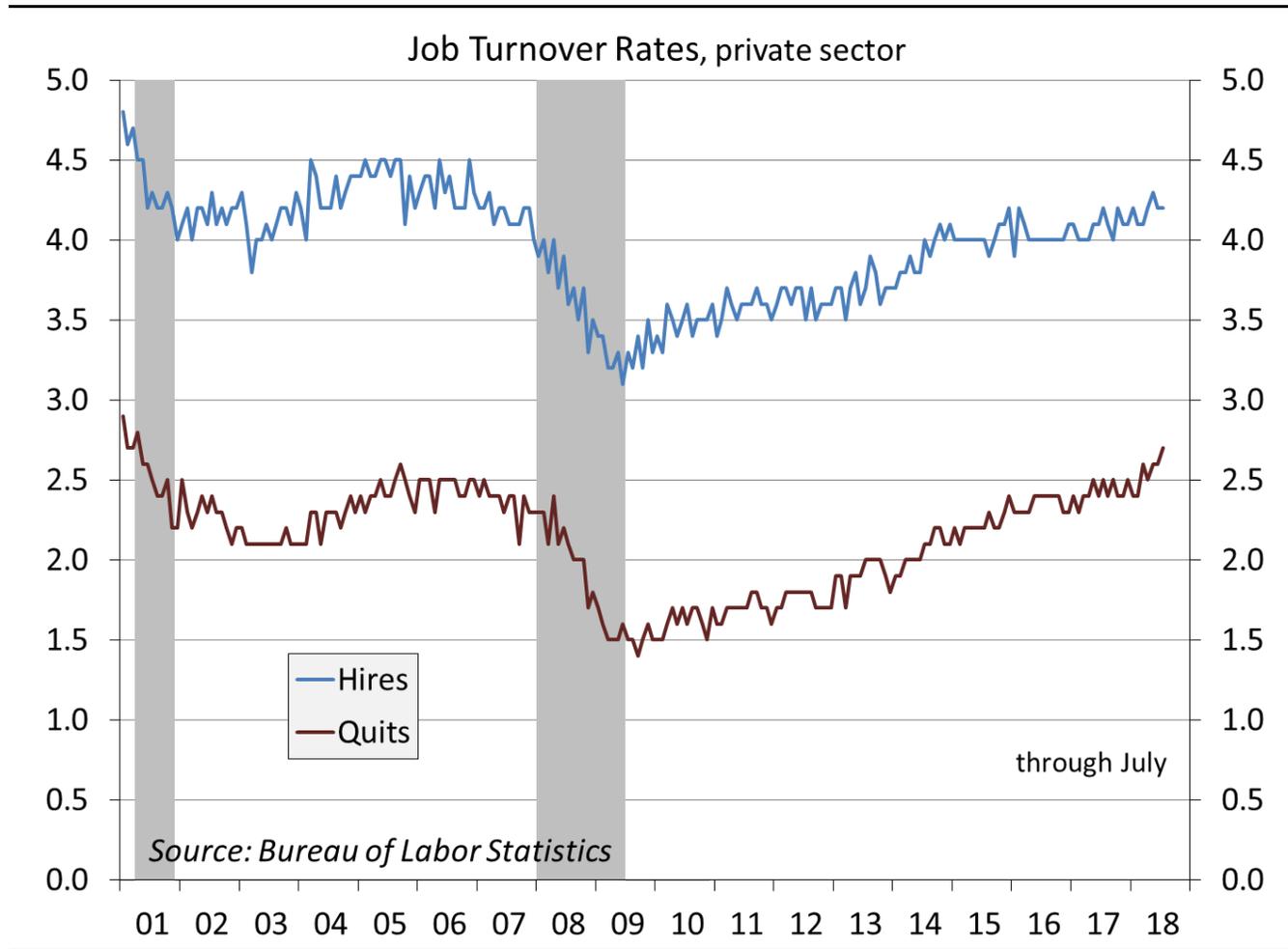
Scott Brown

Involuntary Part-Time Employment Is Trending Lower



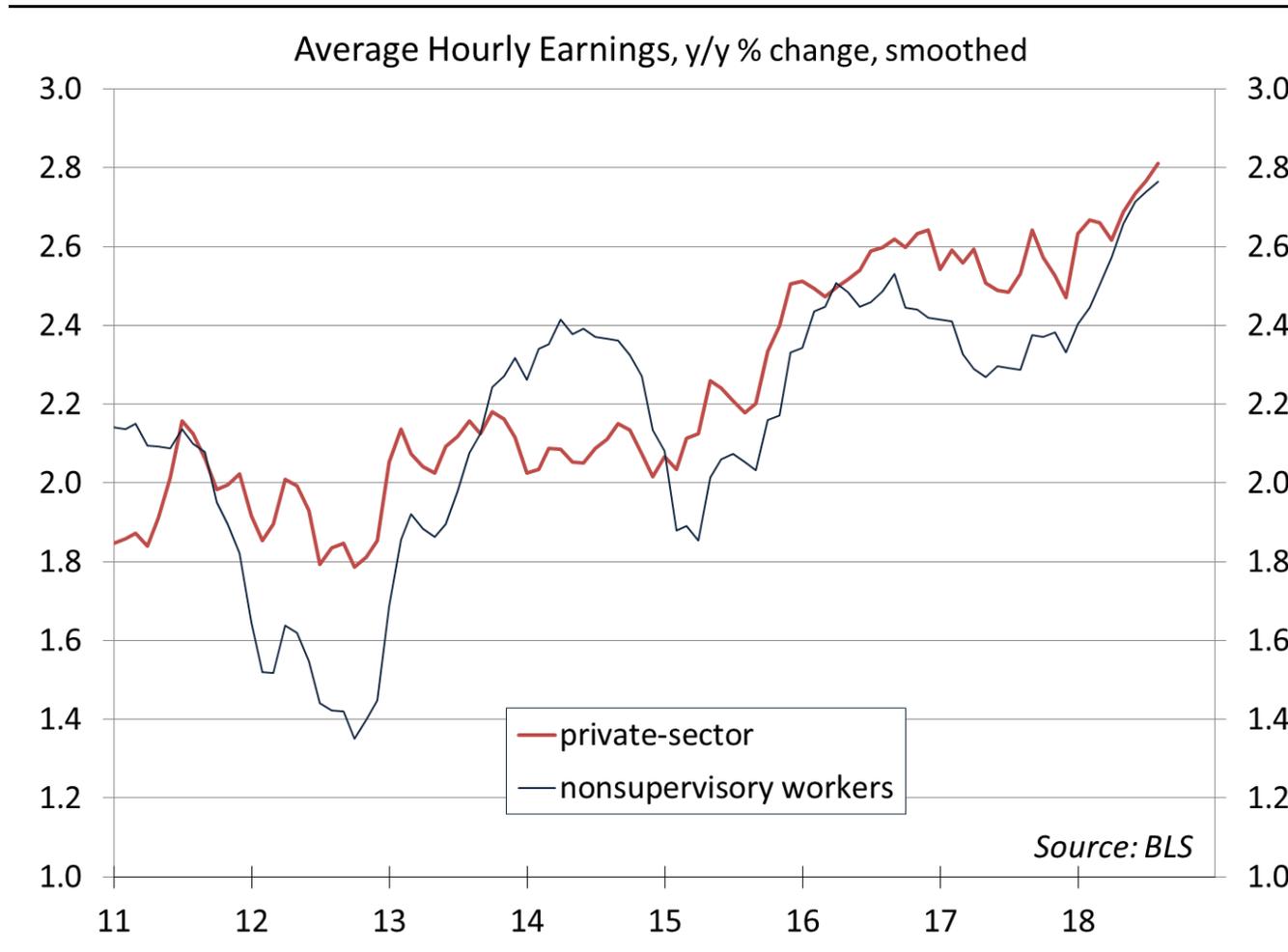
Scott Brown

The Quit Rate Has Risen in a Tight Job Market



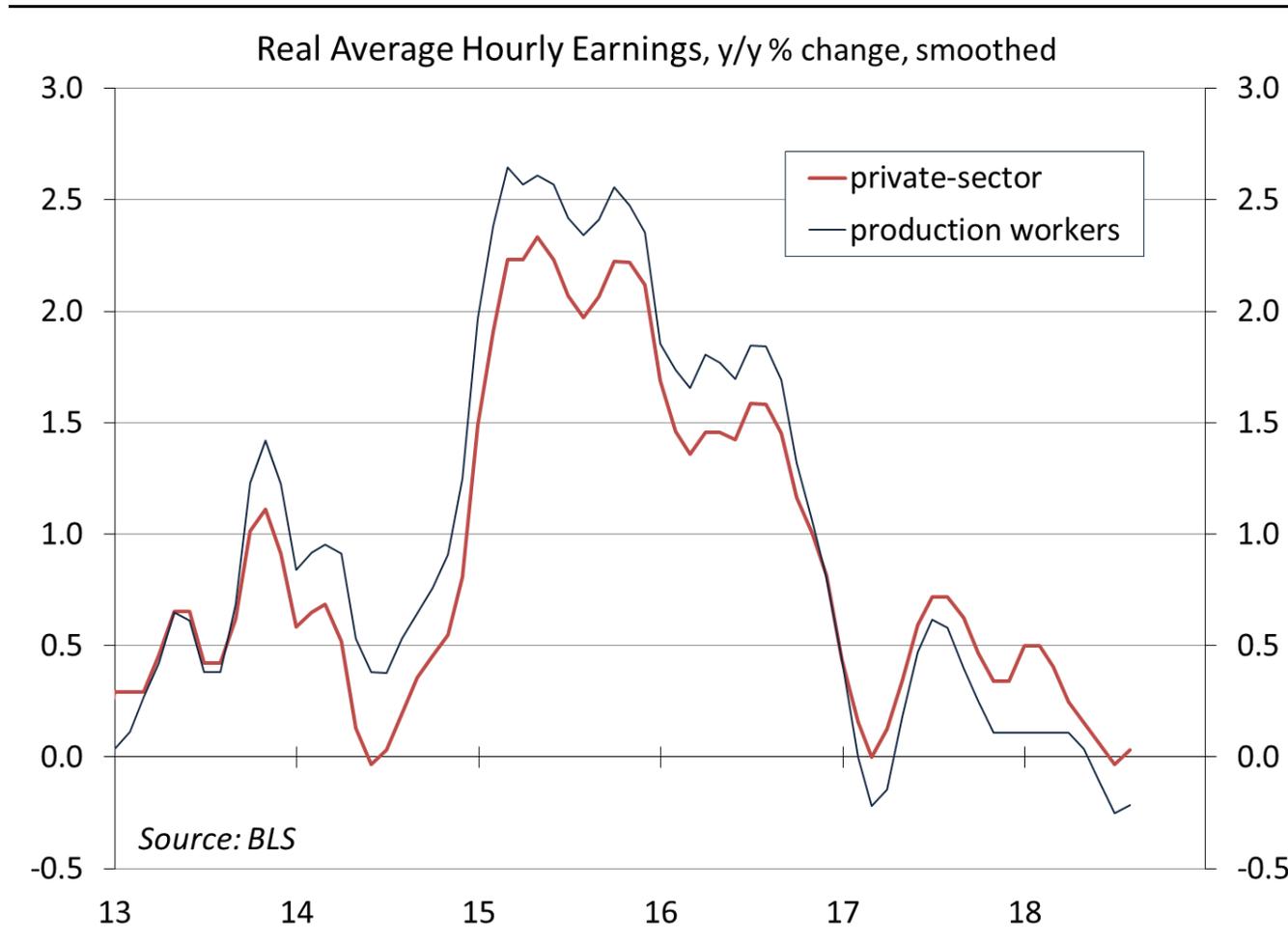
Scott Brown

Nominal (Current \$) Wage Growth Has Picked Up



Scott Brown

Real (Constant \$) Wage Growth Has Been Weak



Scott Brown

Where Is the Wage Growth?

In the past, an unemployment rate of below 4% has been associated with growth in average hourly earnings of 4% or more. What's different now?

Bargaining power has shifted. In the early 1970s, 25% of private-sector employment were union. Union membership was 6.5% in 2017 (public-sector employment is 34% union, but that's a different story). We have seen a greater concentration of large firms over the years, which has had a major impact on wages and prices (this was a theme in the Kansas City Fed's most recent monetary policy symposium).

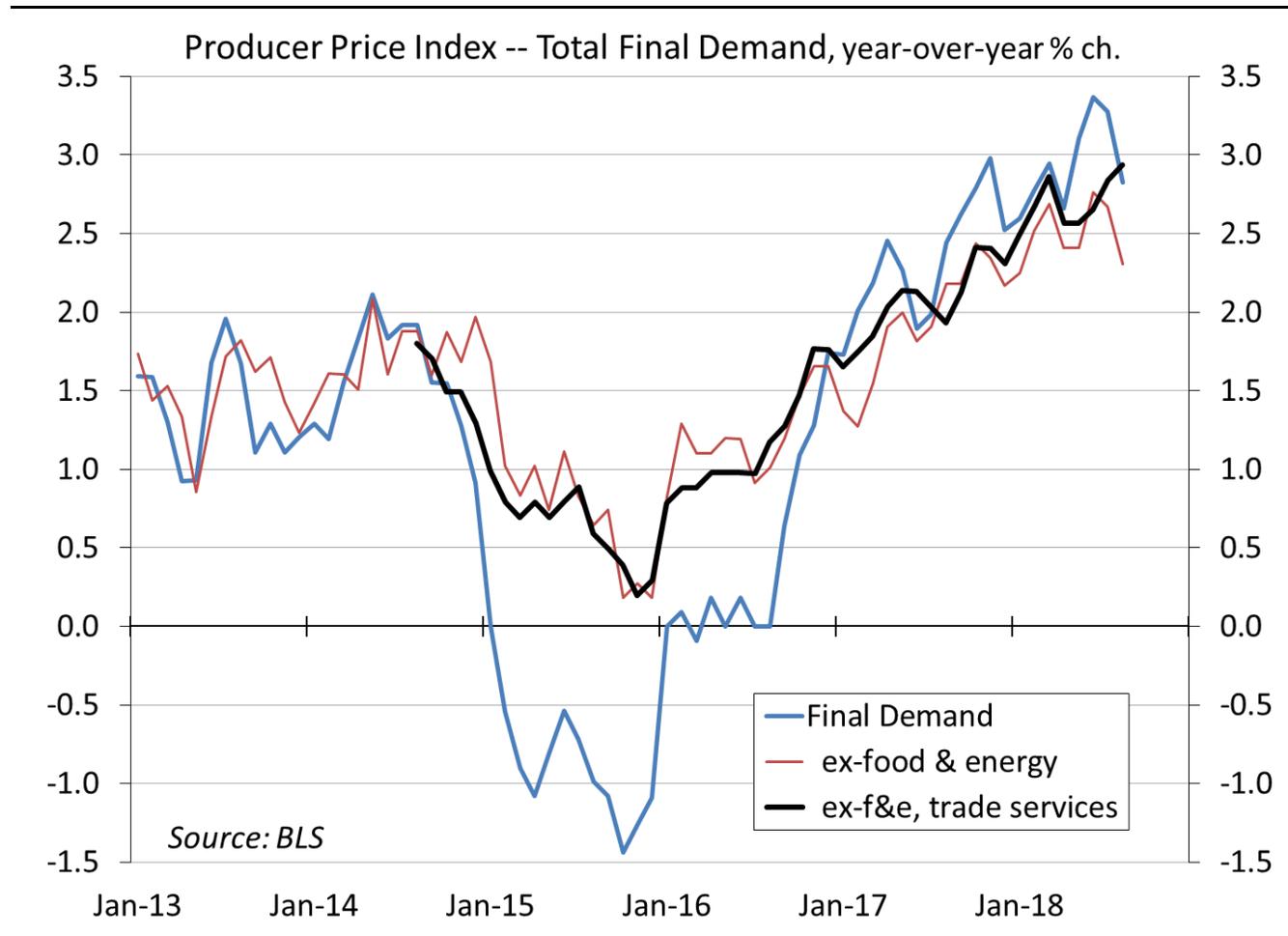
Firms are using alternative measures to attract workers: signing bonuses, stipends to pay down student loans, more time off, and other perks.

Productivity growth remains low. Of course, this might change in a tight job market, leading workers to shift to more productive (higher-paying) jobs. Job mobility ought to be more limited as the population ages. However, quit rates have increased. The question may be how long the Fed is willing to let this (a tight job market) run.

Inflation has remained relatively low. You're going to get your annual "cost of living" increase, but probably not much more.

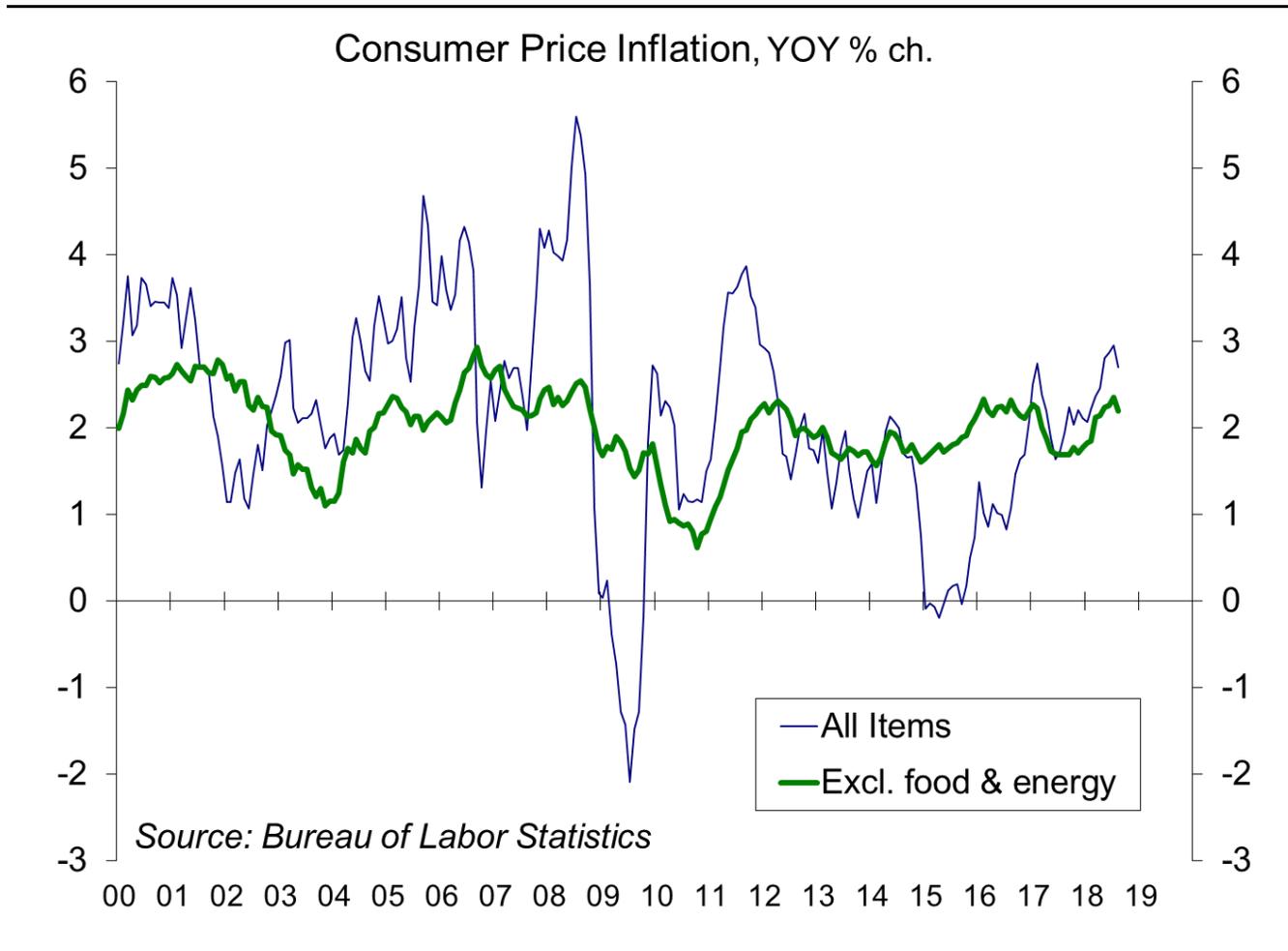
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Pipeline Inflation Pressures, Higher in the First Half of the Year, Have Moderated Somewhat in Recent Months



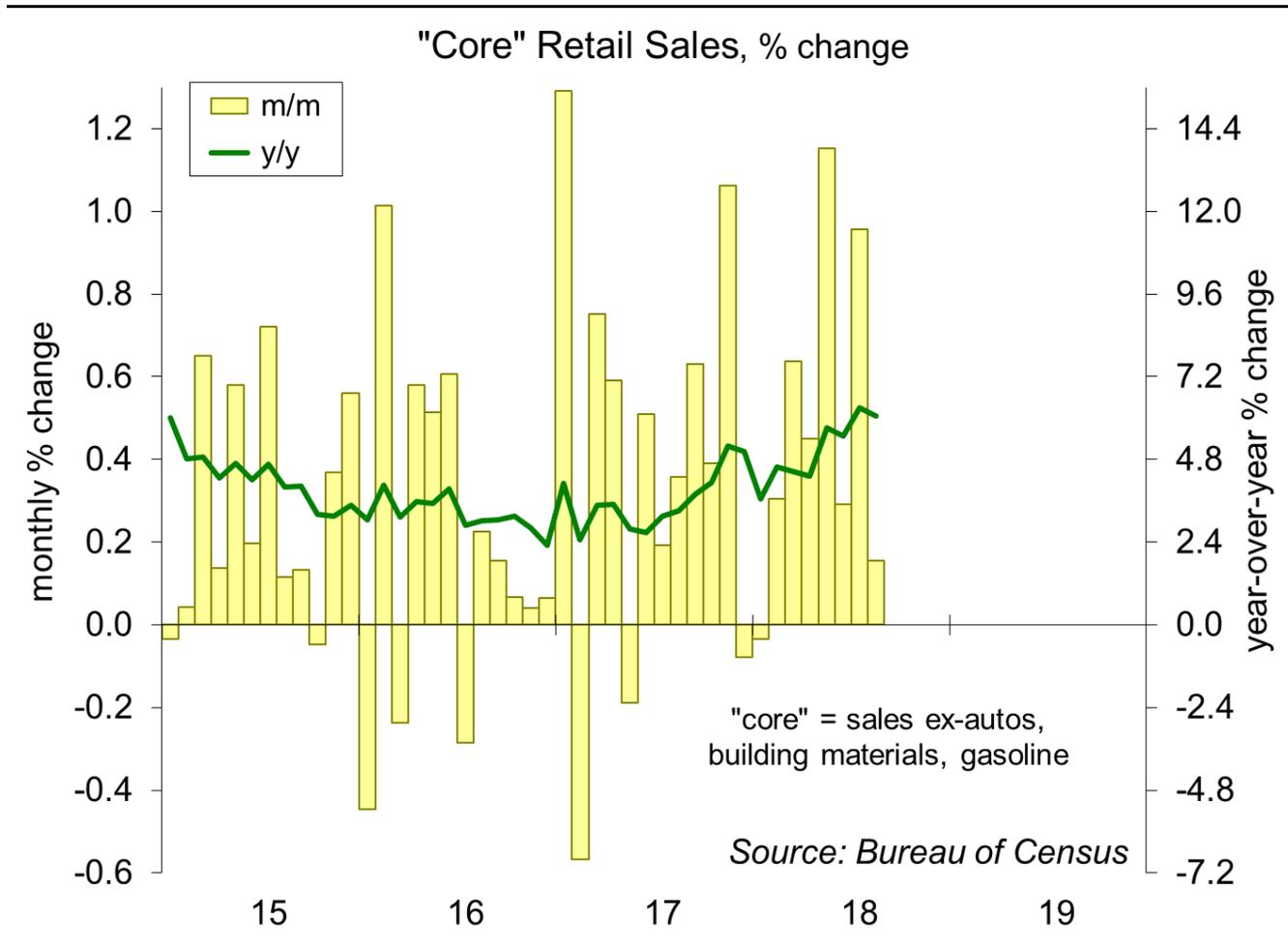
Scott Brown

Consumer Price Inflation Has Remained Moderate



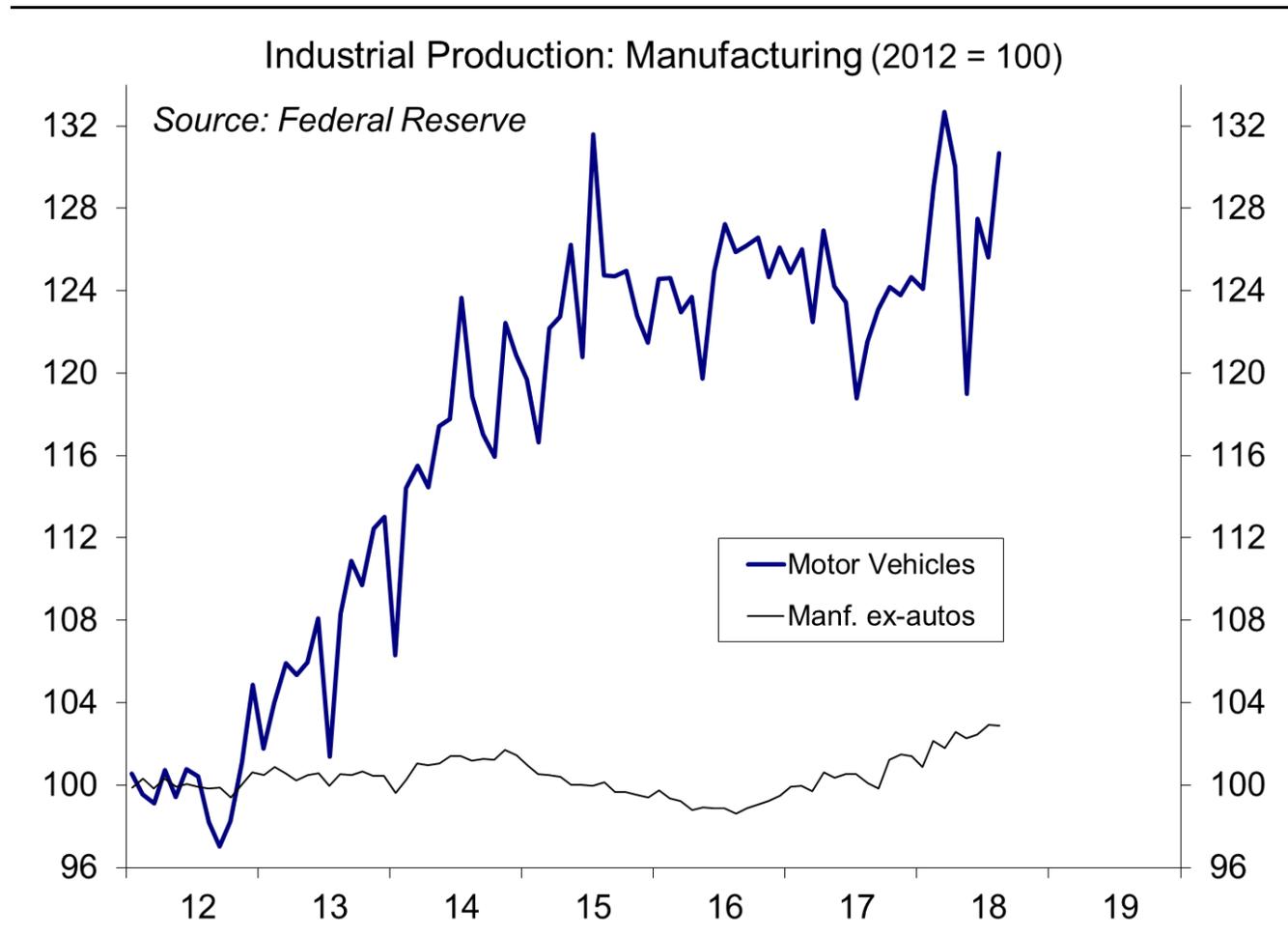
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The Trend in Retail Sales Has Been Moderately Strong



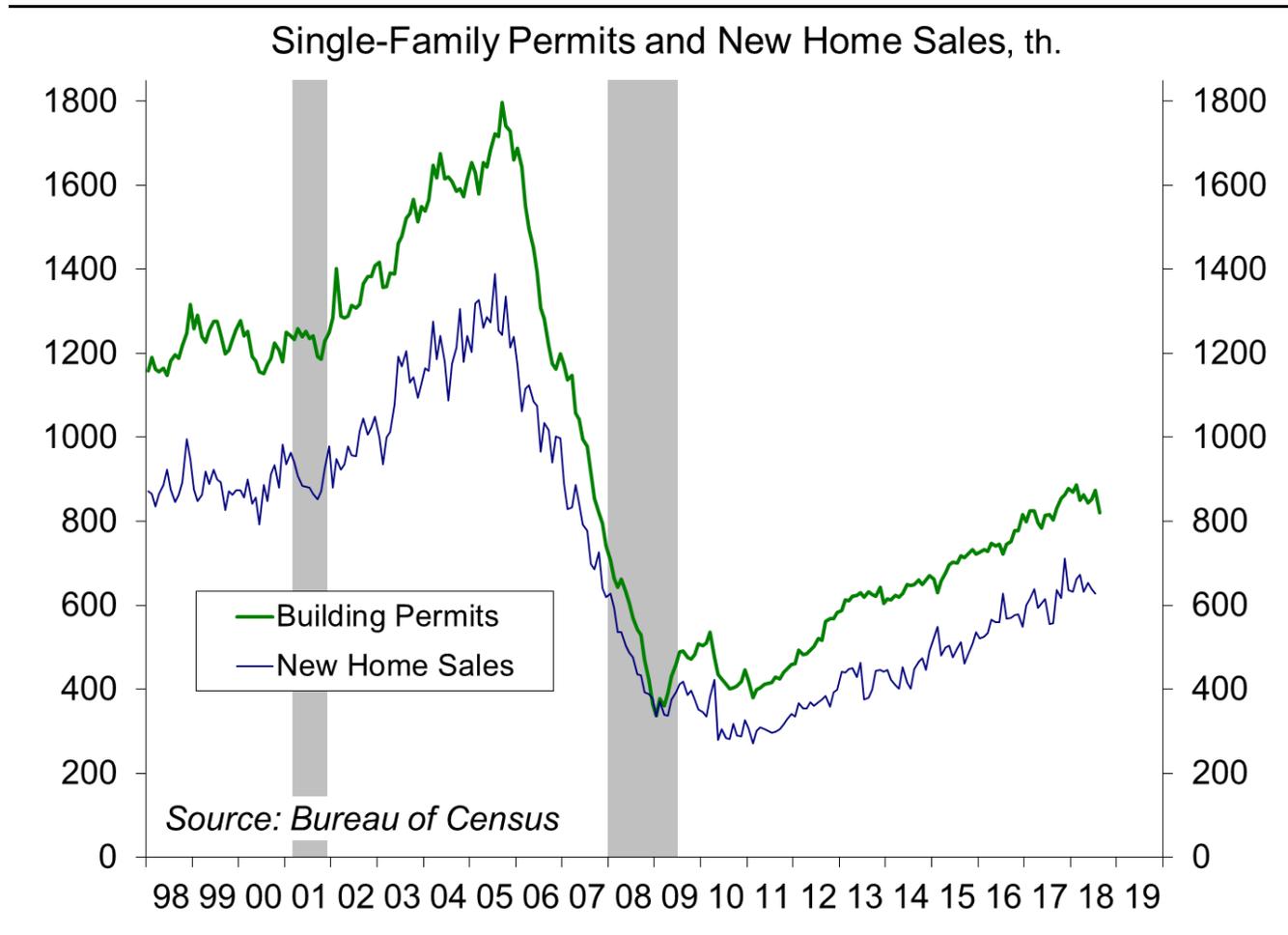
Scott Brown

Factory Output Is Expanding Moderately



Scott Brown

Home Sales and Construction May Be Plateauing



Scott Brown

Fed Policy Outlook

The Federal Open Market Committee is widely expected to raise the federal funds target range by another 25 basis points on September 26 (to 2.00-2.25%). In the FOMC statement, officials are likely to no longer describe monetary policy as “accommodative.” The elimination of this phrase was discussed in the previous policy meeting – and if it remains, a further increase in December would be much more likely (market odds of a mid-December move have recently been around 80%). Note that we will get revised economic projections from the Fed at this meeting, including a new dot plot (out to 2021), and there will be a press conference with Fed Chairman Powell (as a reminder, there will be a press conference after every policy meeting beginning in 2019).

Fed officials are aware of increased policy risks (raising rates too rapidly or too slowly). Policy decisions will remain data dependent – specifically, on what the incoming data imply for the outlook for growth and inflation.

This meeting will include the Fed’s new vice chair, Richard Clarida. Clarida brings important monetary policy expertise to the Fed’s Board of Governors. President Trump is expected to nominate former Fed official Nellie Chiang to the Board of Governors. Chiang would likely focus on financial stability and smart regulation.

Scott Brown**Fed Policy Outlook**

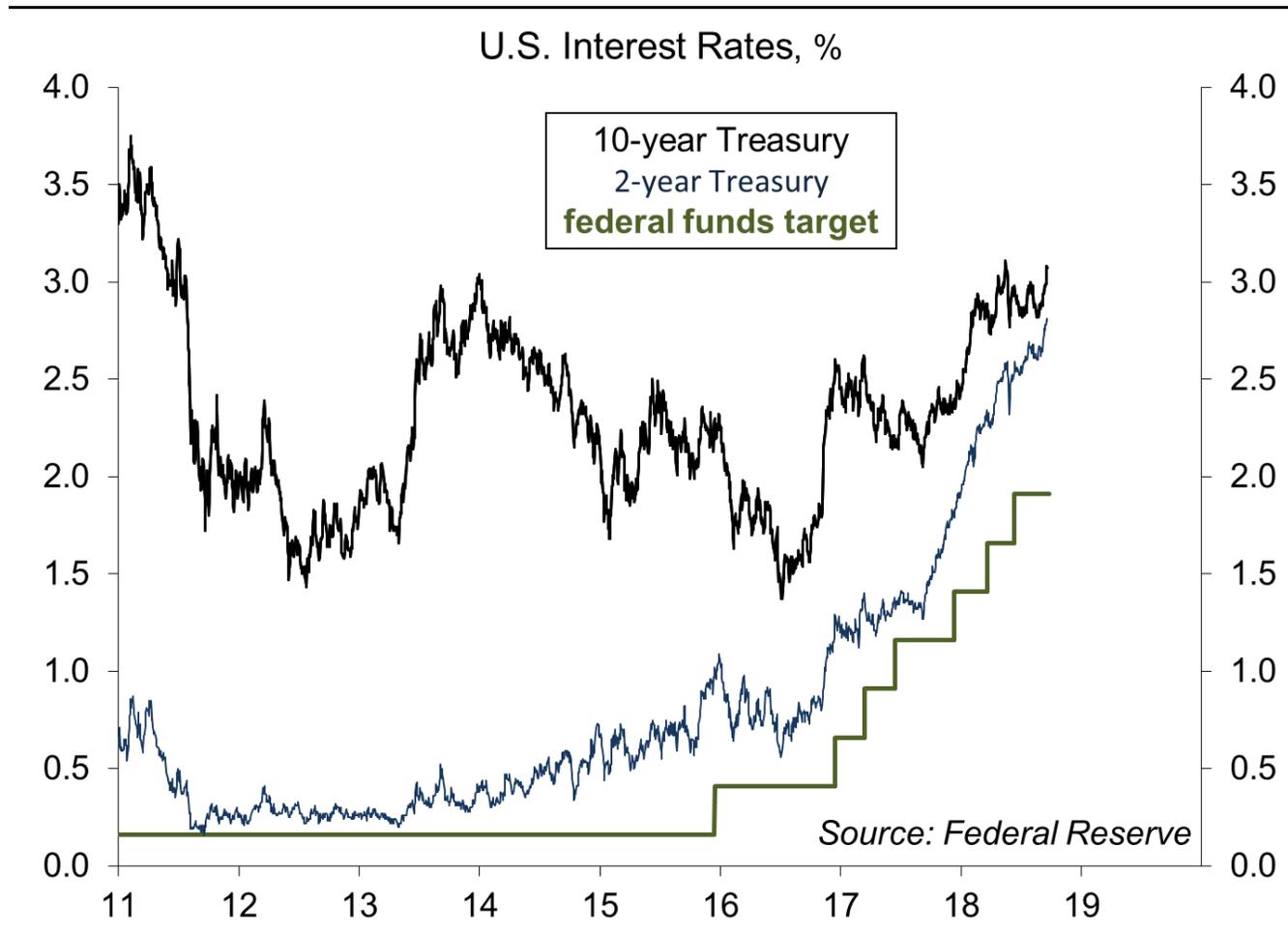
No reason for the Fed to slam on the brakes (raise rates more rapidly):

*“Reports from the Federal Reserve Districts suggested that the economy expanded at a **moderate** pace through the end of August... Consumer spending continued to grow at a **modest** pace since the last report... Manufacturing activity grew at a **moderate** rate in most Districts... Labor markets continued to be characterized as **tight** throughout the country, with most Districts reporting **widespread shortages**... Employment grew **modestly or moderately** across most of the nation... Wage growth was mostly characterized as **modest or moderate**, though a number of Districts cited steep wage hikes for construction workers. Some Districts indicated that businesses were increasingly using benefits--such as vacation time, flexible schedules, and bonuses--to attract and retain workers, as well as putting more resources into training... Prices of final goods and services continued to rise at a **modest to moderate** pace in most Districts, though there were some signs of a deceleration. All Districts noted **fairly widespread input price pressures**, particularly for construction materials and freight transportation. Tariffs were reported to be contributing to rising input costs, mainly for manufacturers.”*

-- Fed Beige Book (September 12)

Scott Brown

The 2-year T-note Implies Further Fed Hikes in 2019



Scott Brown

| Economic Indicator | Status | Comments |
|---------------------------------|---|---|
| Growth |  | GDP growth is expected to remain moderately strong, although somewhat slower in the second half of 2018, reflecting the tight job market and the fading impact of fiscal stimulus. |
| Employment |  | Demand for workers should remain strong and there may be some slack remaining in the labor market, but the pace of job growth is likely to slow as constraints become more binding. |
| Consumer Spending |  | Job growth remains supportive, but inflation-adjusted average earnings are trending flat on a year-over-year basis. |
| Business Investment |  | Sentiment remains strong, although there are some concerns about the negative impact of tariffs. Orders and shipments of capital goods have improved into 3Q18. |
| Manufacturing |  | New orders and production have been mixed, but the pace has been generally moderate. Trade tariffs are a concern, disrupting supply chains and dampening expectations for exports. |
| Housing and Construction |  | Builders continue to note supply constraints (a lack of skilled labor, higher costs). Demand remains strong. Home prices have continued to rise, making affordability an important issue. |
| Inflation |  | Labor cost inflation remains moderate. Core consumer price inflation is at the Fed's goal, but officials have indicated a tolerance for somewhat higher inflation in the near term. |
| Monetary Policy |  | Fed policy is close to neutral, but the neutral federal funds rate can be expected to rise over time. Some Fed officials believe that it may be necessary to raise the federal funds rate above a neutral level in 2019 or 2020 (to align the economy more closely with its potential). |
| Long-Term Interest Rates |  | A strengthening economy, somewhat higher inflation, Fed tightening, and increased government borrowing would normally send bond yields higher. However, long-term interest rates remain low outside the U.S. and there is strong global demand for safe assets. |
| Fiscal Policy |  | Tax cuts and added spending have provided support for economic growth in the near term (more than expected), but budget deficit projections have risen sharply (a long-term concern given the expected strains on Social Security and Medicare funding). |
| The Dollar |  | Trade policy conflicts and concerns about global economic risks have led to a flight to safety into U.S. Treasuries and the dollar. |
| Rest of the World |  | Fed rate increases have had a negative impact on emerging market economies and trade policy has disrupted supply chains. Nationalistic tendencies and Brexit are concerns in Europe. |

Scott Brown

Key Calendar Dates

| | |
|---------------------|--|
| September 26 | FOMC Policy Decision (Powell press conference) |
| November 6 | Election Day |
| November 8 | FOMC Policy Decision (no press conference) |
| December 19 | FOMC Policy Decision (Powell press conference) |
| October 1 | ISM Manufacturing Index (September) |
| October 2 | Powell Speaks (NABE Conference) |
| October 3 | ADP Payroll Estimate (September) ISM Non-Manufacturing Index (September) |
| October 5 | Employment Report (September) |
| October 8 | Columbus Day (bond market closed) |
| October 11 | Consumer Price Index (September) |
| October 15 | Retail Sales (September) |
| October 16 | Industrial Production (September) |
| October 17 | Building Permits, Housing Starts (September) FOMC Minutes (September 25-26) |
| October 24 | New Home Sales (September) Fed Beige Book |
| October 25 | Durable Goods Orders (September) |
| November 2 | Employment Report (October) |
| November 6 | Election Day |
| November 8 | FOMC Policy Decision (no press conference) |
| December 19 | FOMC Policy Decision (Powell press conference) |

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| | Coverage Universe Rating Distribution* | | | Investment Banking Distribution | | |
|--|--|-----|-----------|---------------------------------|-----|-----------|
| | RJA | RJL | RJEE/RJFI | RJA | RJL | RJEE/RJFI |
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| Market Perform (Hold) | 39% | 26% | 33% | 11% | 9% | 0% |
| Underperform (Sell) | 5% | 4% | 15% | 5% | 33% | 0% |

* Columns may not add to 100% due to rounding.

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